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S E C R E T SECTION 01 OF 03 BUDAPEST 001350

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TAGS: [ENRG](#) [ECON](#) [HU](#)

SUBJECT: HUNGARIAN FOREIGN POLICY DRIFTING TO THE EAST

REF: A. BUDAPEST 01190

[1](#)B. BUDAPEST 01140

[1](#)C. BUDAPEST 00666

Classified By: P/E COUNSELOR ERIC V. GAUDIOSI; REASONS 1.4 (B) AND (D)

[1](#)1. SUMMARY: In over a month since PM Gyurcsany's pledge to demonstrate his commitment to the Transatlantic relationship, the GoH's actions continue to give us cause for concern regarding a drift to the east in its policy. Gyurcsany's recent travel to Russia and Ukraine -- in both cases featuring discussion of energy cooperation - and his statements regarding an "emerging Russia," reflect a different perception of strategic advantage and strategic risk. Hungarian officials overemphasize the economic advantages of commercial ties with Russia, and we suspect Budapest's elite business circle -- many of whom seek to establish or expand their presence in Russia (and Ukraine) - favor a closer relationship with Russia, leading the GoH to proclaim its "Western values" even as it pursues its perceived eastern interests. In short: the PM can no longer claim that he has not heard our message, but we cannot yet say that he is listening intently. END SUMMARY.

MISSING THE POINT

[1](#)2. (S) In his July 10 meeting with EUR A/S Daniel Fried, PM Gyurcsany said he had "missed" the strategic challenge posed by Russia's "growing assertiveness" but underscored his "unequivocal commitment" to "serving our common values." He stated explicitly that "we don't need to play games: we are on the same side." (ref B)

[1](#)3. (S) Yet less than 10 days later, Gyurcsany met with Putin in a late-night airport bilateral on the margins of a "Finno-Ugric Summit" to discuss economic cooperation, energy and Kosovo (ref A). In what was Gyurcsany's third face-to-face meeting with Putin over the past year, he agreed to convene a bilateral Joint Economic Committee in Budapest on September 18. (Note: Post notes that September 18 is the Monday following Minister Koka's September 14 Nabucco Conference, a conference to which the GoH may invite Russian representatives.)

[1](#)4. (S) And roughly ten days after his Putin meeting, Gyurcsany announced on July 30 that he is prepared to sign an agreement with Ukraine for one billion cubic meters (bcm) of gas storage. The PM claimed to represent the interests of state-owned electricity company MVM, but industry insiders have suggested the storage would benefit directly Emfesz, which plans to build an enormous 2400 MW gas-powered plant on the Hungarian side of the border. Emfesz's parent company -- RosUkrEnergo -- is owned half by Russian organized crime-linked Ukrainian businessman Dmitry Firtash and half by

Gazprom.

THE EASIER WRONG

15. (C) Gyurcsany and others in his government also seem to magnify the importance of Russian-Hungarian trade relations, often suggesting that the relationship is symbiotic. As one might expect, however, Hungary actually suffers a huge trade deficit vis-a-vis Russia, with agricultural exports failing to balance out energy imports. At the same time underestimating the value of top investors like Germany, the Netherlands and Austria. According to the Investment and Trade Development Authority of Hungary, the cumulated FDI of those three countries from 1990-2004 accounted for 29, 20 and 11 percent, respectively, of foreign investment in Hungary. Similarly, Hungary's Central Statistics Office reported this month that Hungary-EU trade accounted for 81 percent of Hungary's exports and 73 percent of its imports. Though the black market undoubtedly plays a large role in Hungarian-Russian trade relations, thus inflating officially reported figures, much of the GoH's focus on Russian trade seems rooted in a comfort with old networks -- both personal and commercial.

16. (C) For many Hungarian industries -- banking and construction, for example -- the competitive advantage lies in expanding East, with a focus on Russia and the Ukraine and without the perceived strings Western investors attach with respect to transparency. Center-left daily Vilaggazdasag has noted that "as a number of Hungarian industrial companies are preparing to expand their markets in Russia, some backing from the government might do them good." For example:

-- In late June, local property magnate Sandor Demjan -- who

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is known to have the PM's ear -- signed an agreement with the governor of St. Petersburg that will make his company TriGranit the largest real estate developer in Russia's second largest city. The St. Petersburg deal will be in addition to TriGranit's existing projects under its partnership with Gazprominvest.

-- Similarly, OTP Bank CEO Sandor Csanyi -- whose business interests in Hungary span agriculture, viticulture and energy, in addition to banking -- has invested in Russia, with the purchase of Investerbank in June 2006, and in Ukraine, where he announced in the days surrounding Gyurcsany's recent visit (ref A) that OTP would build more than 300 branches by 2010.

-- The richest member of Hungary's Parliament and a leading player in the country's energy sector, MSZP MP Laszlo Kapolyi -- not incidentally the chair of the legislature's sub-committee on energy -- accompanied Gyurcsany to his latest meeting with Putin. Opposition sources allege that Kapolyi is among the leading proponents of the Ukraine deal, which they charge will provide gas to a power plant he plans to build in eastern Hungary.

-- Finally, even MOL CEO Zsolt Hernadi, despite cries of Russian involvement in OMV's takeover attempt, has forged strong ties with Gazprom, cooperating on the feasibility study for the Blue Stream extension and inviting the Russian company's cooperation in the strategic gas storage facility MOL will build for the GoH. With Hungary's leading business and opinion makers seeking their fortunes in the east, perhaps we should be unsurprised that Gyurcsany would take his cues from the private sector, where he made his own fortune.

DESPERATELY SEEKING . . . SOMETHING

17. (C) Gyurcsany's private questions as to "who the hell would want to rely on Russia" contrast with his public comments. His recent statements on Hungary's role in the

Euro-Atlantic community -- themselves a welcome departure from his long silence on this front but a curious statement from an EU member -- lack the personal enthusiasm so evident in his remarks on the "new Russia." Addressing the Hungarian Ambassadors and the diplomatic corps on July 30, the PM emphasized the dynamism of the "emerging Russia," underscoring its lack of dependence on foreign investment and describing what he perceives as an historic shift of power from the West and toward the East.

18. (C) There is also, we sense, something more personal. Gyurcsany has returned repeatedly to the issue of Putin's popularity, including a reference in his July 30 remarks that "Russian women are begging Putin to stay." Under Putin's doubtless careful management of their relationship, Gyurcsany has been made to feel welcome -- something he has not been on the European circuit given his domestic baggage and what one Western Ambassador here described as a woeful lack of preparation for high-level meetings. Although upcoming meetings with Merkel, Sarkozy, and Prodi may help address this sense of isolation, Gyurcsany may also have come to see Putin as many things he himself is not -- secure in his domestic position and "confident" in his international actions.

"WESTERN VALUES" ... AND EASTERN INTERESTS

19. (S) COMMENT: Over a year of effort including direct outreach to the Prime Minister, we have made clear our hope that Hungary will "find its voice" - and reaffirm its place - in the West. As one Western Ambassador here commented, with its long-standing political, social and economic ties to Hungary, Russia seems intent on winning the race for "most favored" status in Hungarian foreign policy. Despite Moscow's considerable historical baggage, it is often the perception of second class treatment from the EU15 (as well as perceived double-standard that allows other European states to pursue deals with Moscow) that rankles Hungarians most. As a result, one contact has commented that Hungary is "officially part of the EU." But an ambivalent part, and this conflict has left the door open for Putin. Gyurcsany and others continue to assert that the problem is one of communication (as he has done with his reform agenda), but even his recent statements reaffirming Hungary's alignment have emphasized "Western values" ... while making clear Hungary's attachment to what it regards as its eastern interests. END COMMENT.

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